Essentials of

Services Marketing

3rd Edition

6 Distributing Services THROUGH PHYSICAL AND ELECTRONIC CHANNELS

WIRTZ LOVELOCK

Learning Objectives

6.1 Recognize that effective pricing is central to the financial success of service firms.

6.2 Outline the foundations of a pricing strategy as represented by the pricing tripod.

6.3 Define different types of financial costs and explain the limitations of cost-based pricing.

6.4 Understand the concept of net value and know how gross value can be enhanced through value-based pricing and reduction of

Copyright © 2018 Pearson Education

Learning Objectives

6.5 Describe competition-based pricing and situations where service markets are less price-competitive.

6.6 Define revenue management and describe how it works.

6.7 Discuss the role of rate fences in effective revenue management.

6.8 Be familiar with the issues of ethics and consumer concerns related to service pricing.

Copyright © 2018 Pearson Education

Learning Objectives

6.9 Understand how fairness can be designed into revenue management policies.

6.10 Discuss the six questions marketers need to answer to design an effective service- pricing strategy.

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.1

Recognize that effective pricing is central to the financial success of service firms.

Effective pricing for financial success

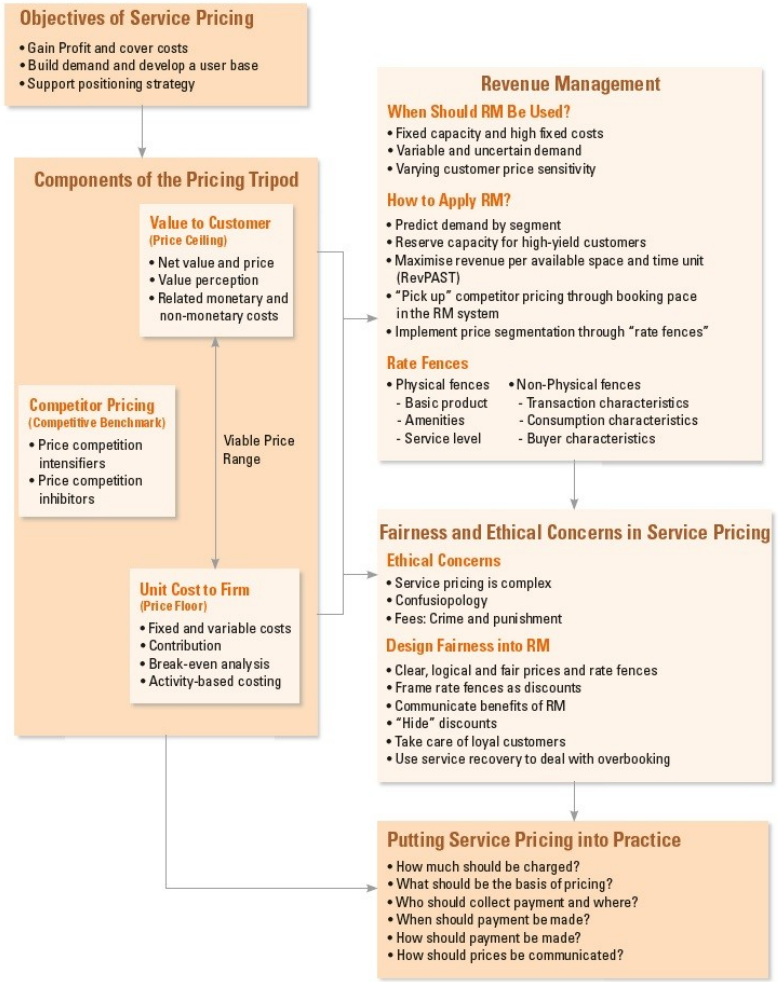

Objectives of Service Pricing
• Gain Profit and cover costs
• Build demand and develop a user base
• Support positioning strategy
Components of the Pricing Tripod
Value to Customer
(Price Ceiling)
• Net value and price
• Value perception
• Related monetary and non-monetary costs
Competitor Pricing
(Competitive Benchmark)
• Price competition intensifiers
• Price competition inhibitors
Viable Price Range
Unit Cost to Firm
(Price Floor)
• Fixed and variable costs
• Contribution
• Break-even analysis
• Activity-based costing
Revenue Management
When Should RM Be Used?
• Fixed capacity and high fixed costs
• Variable and uncertain demand
• Varying customer price sensitivity
How to Apply RM?
• Predict demand by segment
• Reserve capacity for high-yield customers
• Maximise revenue per available space and time unit (RevPAST)
• "Pick up" competitor pricing through booking pace in the RM system
• Implement price segmentation through "rate fences"
Rate Fences
• Physical fences
- Basic product
- Amenities
- Service level
• Non-Physical fences
- Transaction characteristics
- Consumption characteristics
- Buyer characteristics
Fairness and Ethical Concerns in Service Pricing
Ethical Concerns
• Service pricing is complex
• Confusiopology
• Fees: Crime and punishment
Design Fairness into RM
• Clear, logical and fair prices and rate fences
• Frame rate fences as discounts
• Communicate benefits of RM
• "Hide" discounts
• Take care of loyal customers
• Use service recovery to deal with overbooking
Putting Service Pricing into Practice
• How much should be charged?
• What should be the basis of pricing?
• Who should collect payment and where?
• When should payment be made?
• How should payment be made?
• How should prices be communicated?

Figure 6.3 Organizing framework for the pricing of services.

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.2

Outline the foundations of a pricing strategy as represented by the pricing tripod.

Foundations of a Pricing Strategy

- Pricing Strategy Stands on Three Legs

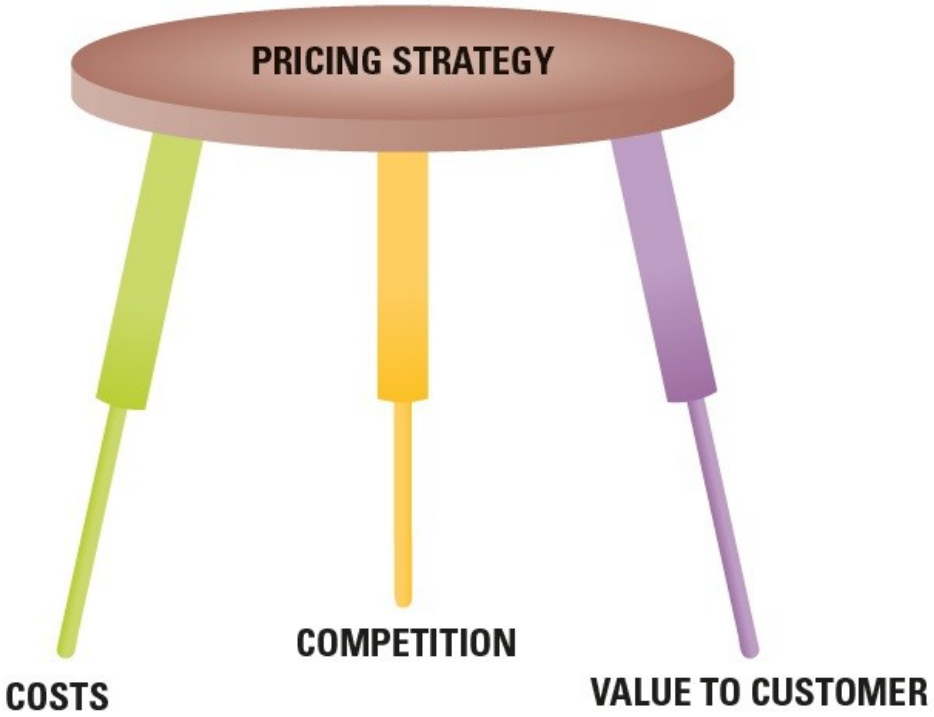


Figure 6.4 The pricing tripod.

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.3

Define different types of financial costs and explain the limitations of cost-based pricing.

Cost-Based Pricing

- Set prices relative to financial costs (problem: defining costs)
- Activity-based costing
- Pricing implications of cost analysis

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.4

Understand the concept of net value and know how gross value can be enhanced.

Value-based pricing

- Understanding Net Value:
  - Customers weigh the perceived benefits of the service against perceived costs they will incur.
    - Value is a low price.
    - Value is whatever I want in a produc
    - Value is the quality I get for the price
    - Value is what I get for what I give.

- Managing the Perception of Value:
  - Effective communications and even personal explanations are needed to help customers understand the value they receive.

Copyright © 2018 Pearson Education

Value-based pricing

Reducing Related Monetary and Non-Monetary Costs

- Reduce related-monetary costs.
  - Cut time spent searching for, purchasing and using service
- Reduce non-monetary cos
  - Time Costs
  - Physical Costs
  - Psychological (Mental) Costs
  - Sensory Costs (unpleasant s sounds, feel, tastes, smells)

Copyright © 2018 Pearson Education

Value-based pricing

- Service users can incur costs during any of the three stages of the service consumption model

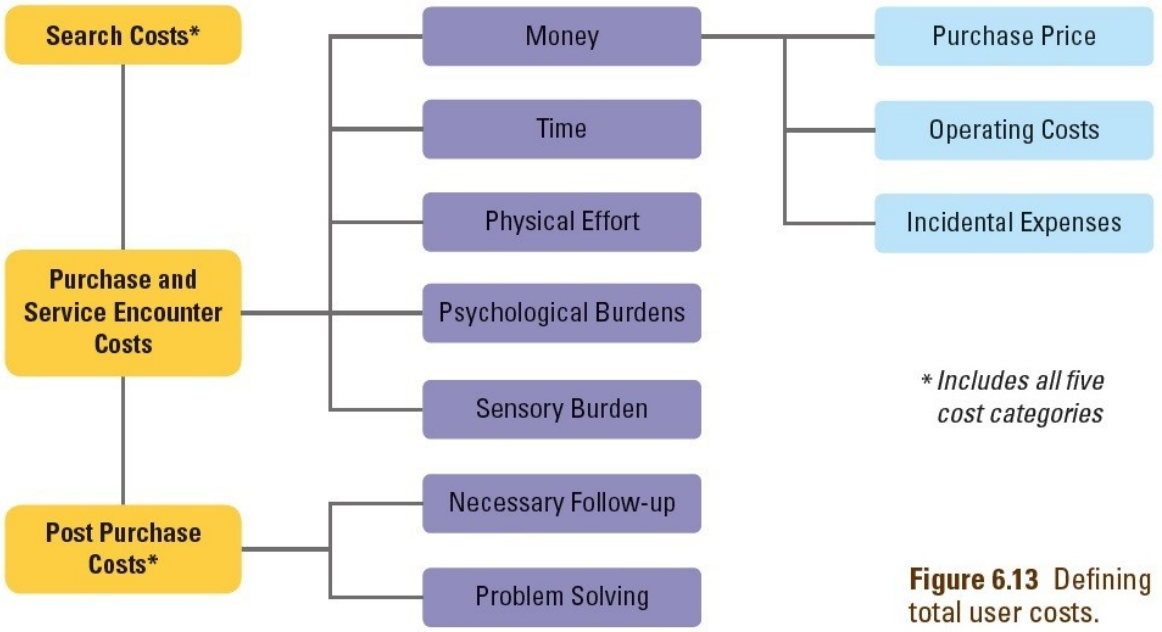


Figure 6.13 Defining total user costs.

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.5

Describe competition-based pricing and situations where service markets are less price-competitive.

Competition-based pricing

- Non-price-related costs of using competing alternatives are high
- Personal relationships matter
- Switching costs are high
- Time and location specificity reduces choice
- Managers should not only look at competitor's prices dollar for dollar, but should examine all related financial and non-monetary costs

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.6

Define revenue management and describe how it works.

Define revenue management and describe how it works

Maximizing Revenue from Available Capacity at a Given Time

- Most effective when
  - Relatively high fixed capacity
  - High fixed cost structure
  - Perishable inventory
  - Variable and uncertain demand
  - Varying customer price sensitivity
- Revenue management is price customization
  - Charge different value segments different prices for same product based on price sensitivity

Copyright © 2018 Pearson Education

Revenue management

Maximizing Revenue from Available Capacity at a Given Time

- Revenue management is price customization
  - Charge different value segments different prices for same product based on price sensitivity

Copyright © 2018 Pearson Education

Revenue management

Maximizing Revenue from Available Capacity at a Given Time

- Most effective when
  - Relatively high fixed capacity
  - High fixed cost structure
  - Perishable inventory
  - Variable and uncertain demand
  - Varying customer price sensitivity

Copyright © 2018 Pearson Education

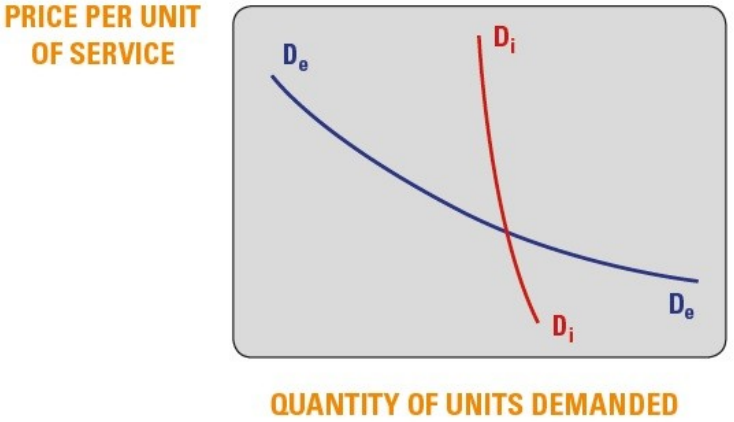
Revenue management

Maximizing Revenue from Available Capacity at a Given Time

- Revenue management uses mathematical models to examine historical data and real time information to determine
  - What prices to charge within each price bucket
  - How many service units to allocate to each bucket
- Rate fences deter customers willing to pay more from trading down to lower prices (minimize consumer surplus)

Copyright © 2018 Pearson Education

Revenue management



$$\text{Price elasticity} = \frac{\text{Percentage change in demand}}{\text{Percentage change in price}}$$

D_e: Demand is *price elastic*. Small changes in price lead to big changes in demand.

D_i: Demand for service is *price inelastic*. Big changes in price have little impact on demand.

Figure 6.18 Illustration of price elasticity.

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.7

Discuss the role of rate fences in effective revenue management.

Role of rate fences

Key Categories of Rate Fences: Physical

RATE FENCES	EXAMPLES
Physical (product-related) Fences • Basic product	• Class of travel (business/economy class) • Size of rental car • Size and furnishing of a hotel room • Seat location in a theater or stadium
• Amenities	• Free breakfast at a hotel, airport pick up, etc. • Free golf cart at a golf course • Valet parking
• Service level	• Priority wait-listing, separate check-in counters with no or only short queues • Improved food and beverage selection • Dedicated service hotlines • Personal butler

Copyright © 2018 Pearson Education

Role of rate fences

Key Categories of Rate Fences: Non-Physical (1)

RATE FENCES	EXAMPLES
Non-Physical Fences *Transaction Characteristics*	
• Time of booking or reservation	• Discounts for advance purchase
• Location of booking or reservation	• Passengers booking air-tickets for an identical route in different countries are charged different prices. • Customers making reservations online are charged a lower price than those making reservations by phone
• Flexibility of ticket usage	• Fees/penalties for cancelling or changing a reservation (up to loss of entire ticket price) • Non-refundable reservations fees

Copyright © 2018 Pearson Education

Role of rate fences

Key Categories of Rate Fences: Non-Physical (2)

RATE FENCES	EXAMPLES
Consumption Characteristics	
• Time or duration of use	• Early bird special in a restaurant before 6:00pm • Must stay over a Saturday night for an hotel booking. • Must stay at least for five nights
• Location of consumption	• Price depends on departure location, especially in international travel. • Prices vary by location (between cities, city center versus edges of the city)

Copyright © 2018 Pearson Education

Role of rate fences

Key Categories of Rate Fences: Non-Physical (3)

RATE FENCES	EXAMPLES
Buyer Characteristics	
• Frequency or volume of consumption	• Member of certain loyalty-tier with the firm (e.g. Platinum member) get priority pricing, discounts or loyalty benefits
• Group membership	• Child, student, senior citizen discounts • Affiliation with certain groups (e.g. Alumni) • Corporate rates
• Size of customer group	• Group discounts based on size of group
• Geographic location	• Local customers are charged lower rates than tourists • Customers from certain countries are charged higher prices

Copyright © 2018 Pearson Education

Role of rate fences

Relating Price Buckets and Fences to Demand Curve

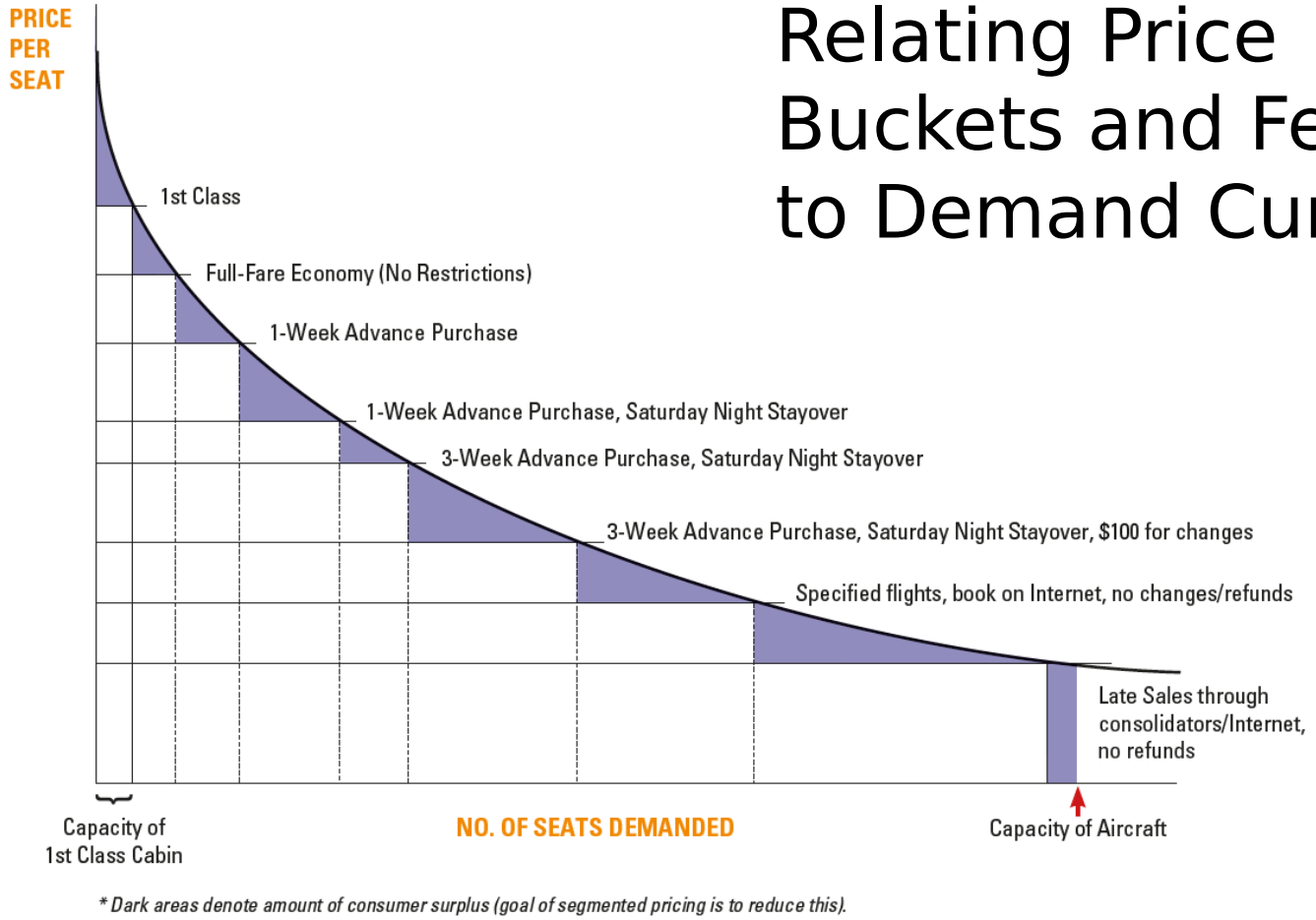

PRICE PER SEAT
1st Class
Full-Fare Economy (No Restrictions)
1-Week Advance Purchase
1-Week Advance Purchase, Saturday Night Stayover
3-Week Advance Purchase, Saturday Night Stayover
3-Week Advance Purchase, Saturday Night Stayover, $100 for changes
Specified flights, book on Internet, no changes/refunds
Late Sales through consolidators/Internet, no refunds
Capacity of 1st Class Cabin
NO. OF SEATS DEMANDED
Capacity of Aircraft
* Dark areas denote amount of consumer surplus (goal of segmented pricing is to reduce this).

Figure 6.20 Relating price buckets to the demand curve.

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.8

Be familiar with the issues of ethics and consumer concerns related to service pricing.

Issues of ethics and consumer concerns

- Customers are vulnerable when service is hard to evaluate as they assume that higher price indicates better quality
- Many services have comp
  - Hard to understand
  - Difficult to calculate full cos in advance of service
- Quoted prices not the onl prices
  - Hidden charges
  - Many kinds of fees
- Too many rules and regulations
  - Customers feel constrained, exploited
  - Customers face unfair fines and penalties

Copyright © 2018 Pearson Education

Distributing Services through Physical and Electronic Channels

6.9

Understand how fairness can be designed into revenue management policies

How fairness can be designed

- Design clear, logical and fair price schedules and fences
- Use high published prices and present fences as opportunities for discounts (rather than quoting lower prices and using fence as basis to impose surcharges
- Communicate consumer benefits of revenue management
- Use bundling to “hide” discounts
- Take care
- Use servi r overbooking

Copyright © 2018 Pearson Education

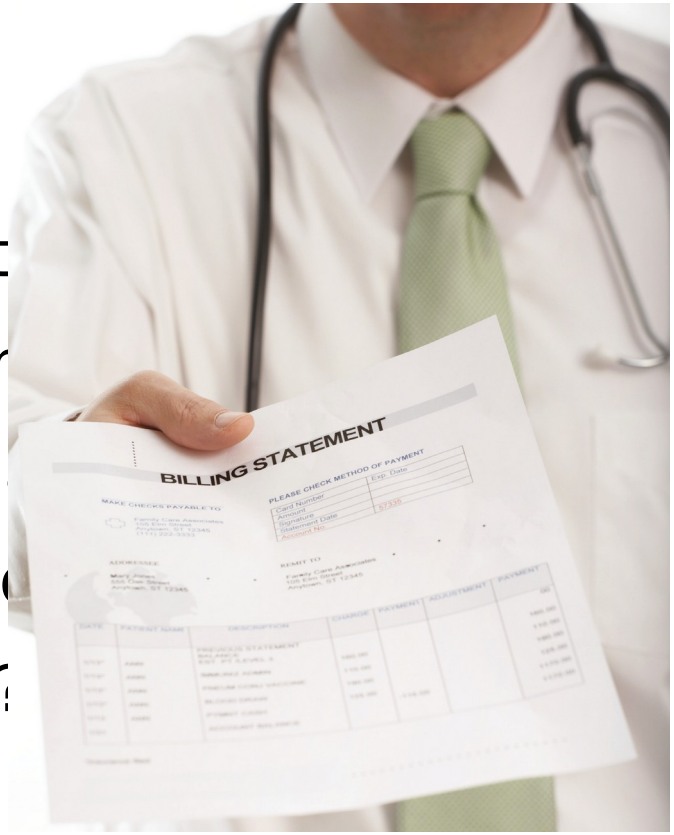
Distributing Services through Physical and Electronic Channels

6.10

Discuss the six questions marketers need to answer to design an effective service-pricing strategy.

Putting Strategy into Practice

- How much to charge?
- What basis for pricing?
- Who should collect payment
- Where should payment be m
- When should payment be m
- How should payment be ma
- How to communicate prices?



Copyright © 2018 Pearson Education

Thank You.